

CONTENTS



82 *When the Magic Goes:* Video-game king Nolan Bushnell's dream fades.



108 *States Report:* The fourth annual survey of state business climates.



135 *Payton's Place:* Bob Payton brings a bit of America to Europe.

7 FYI

States report: turning the tables

10 Letters

"Vulture" capital; a name at any other price; Cookie War II; competitive nightmares

Speaking out

14 The Democrats' secret weapon: Entrepreneurs

When Democrats around the country take a close look at our economy, they will realize that entrepreneurial companies are not part of the problem, but part of the solution.

21 People & innovations

Lore Harp as venture capitalist; the swimsuit competition; David Birch says to practice what you teach; software for nontypists

37 News & trends

ESOP changes could up the acquisition ante; home is where the work is; a business "mating" service

53 Fleshing out an empire

Can Tom Fatjo do for fitness what he did for waste management?

67 Reading, writing, and revenues

Student entrepreneurs are determined not to let school get in the way of their education.

INC. Cover Story

82 When the magic goes

The rise and fall of Nolan Bushnell, the sorcerer of Silicon Valley.

100 Courting bankruptcy

When the president of Bildisco filed for Chapter 11, he didn't know he would be rewriting the bankruptcy laws.

INC. Special Report

108 INC.'s Fourth Annual Report on the States

110 Rating the states based on five major factors

112 Best of show

116 State of the states

How some of the states measure up in the ratings.

120 Update: ripples and sequels

135 Payton's place

London's most brilliant restaurateur slathers a bit of America on every dish. The English eat it up.

149 Ideas you can use

Crime report; cash for clean lungs; adoption policy

Managing people

153 An ounce of prevention

Many companies are rethinking—and rewriting—personnel policies to help head off employee lawsuits.

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Herman Kolgan/Black Star

53 *Fleshing out an empire: Tom Fatjo aims to provide fitness nationwide.*

Special effects

In a marketing battle with giant competitors, Hudepohl Brewing Co. has found that special events can give it an edge.

Financial tactics

171 **Taxing matters**

The Deficit Reduction Act of 1984 is bad news for small business.

Capital

178 **Building on "junk"**

How a Minnesota lumber company used nonrated bonds to finance its growth; a computer retailer that discovered the perils of the public market

182 **Investing in growth companies/Street talk**

Fast-talking founders imperil their stocks.

185 **Your money**

How the pros pick growth stocks.

Cover photo

Mark Hanauer



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INC./OCTOBER 1984 3

INC.'S FOURTH ANNUAL

REPORT ON THE STATES

Can states become more attractive breeding grounds for smaller companies? Increasingly, governors and legislators around the United States have been answering with a determined yes. INC.'s Fourth Annual Report on the States once again ranks the 50 states on factors that are important to small businesses. Beyond these

numbers, we examine some of the more interesting efforts of states to improve their business environments: Ohio's struggle against a legacy of bureaucratic neglect (see page 116); Louisiana's plan to shift gears into a new economy (page 122); California's attempt to keep its pot boiling (page 119); South Caro-

lina's push to find more risk capital (page 122); and Washington's drive to put its volatile economy on the path of steady growth (page 120). Running through these stories is a common thread—a growing awareness that, when it comes to changing a state's business climate, all the solutions are long-term.

By Bruce G. Posner

As long as states have elected governors and legislatures, job generation and business growth have been the subject of political debate, but the politics have changed over time. During the 1960s and '70s, for example, public officials strove mightily to attract large manufacturing facilities and branch offices of national companies. Politicians thought that landing—and keeping—big companies was paramount to the economic vitality of any state. Then, in the early 1980s, a new trend emerged as governors across America began tripping over themselves to establish the next hot spots of high technology.

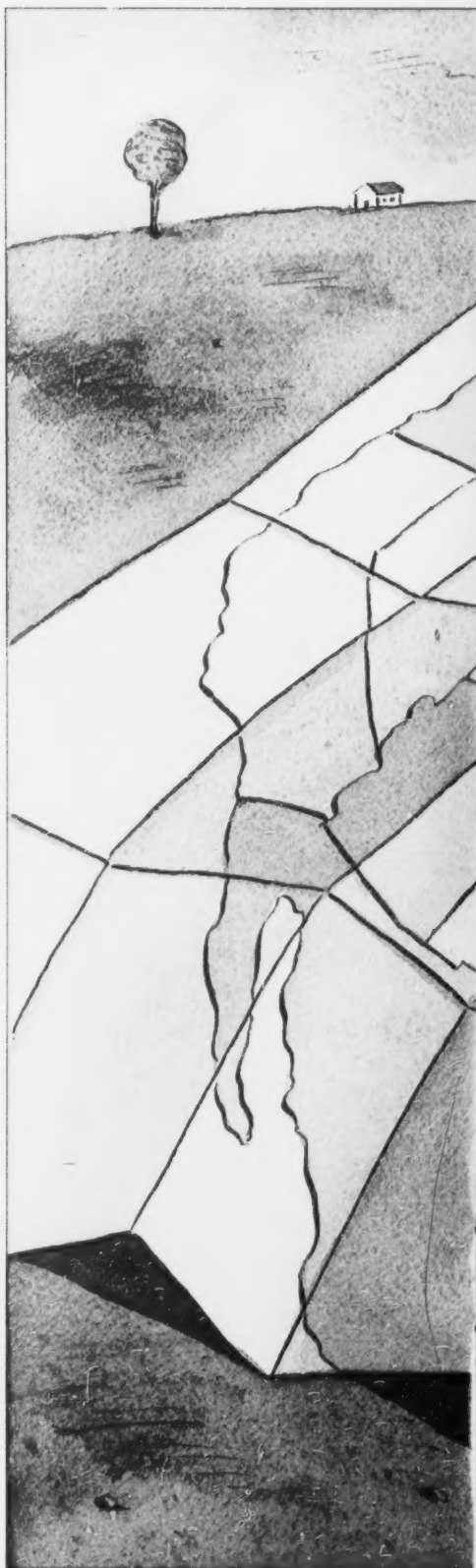
Today, while economic development officials continue to deemphasize strategies aimed at big companies, the passion for high tech has expanded into a growing concern for smaller companies in general. And as attitudes toward smaller companies have changed, so too have ideas about economic development. "We now realize that the lion's share of our new jobs will come from entrepreneurial efforts," says John Mutz, Indiana's lieutenant governor.

Of course, many factors that affect a state's small-business climate are beyond the influence of policymakers—changes in national and international markets, for example. Each region, moreover, has its

own history and its own set of amenities that contribute to its "quality of life." It is difficult enough to *define* all the intangibles conducive to a positive environment for small companies. It is harder still to *create* them.

But there are some things that state governments can do. Many have been taking steps to leverage the resources of both the public and private sectors by making capital more available and improving the quality of the labor force. In the past year, for instance, 7 more states have established state-sponsored venture capital funds, bringing the total to 15. All over the United States, legislatures are increasing budget allocations for higher education and job training. Beyond that, governors and legislatures are attempting to keep in touch with the changing needs of small businesses through advisory offices and special legislative committees.

In this report, INC. compares the 50 states on a variety of important, quantifiable factors that contribute to the general climate for small business. The purpose of this study is to provide businesspeople and policymakers with information and ideas to assist them in their ongoing efforts to make improvements. The report concentrates on three major areas—capital, labor resources, and taxes. INC. also surveyed the states for small-business support activities and new programs initiated by either governors or legislatures. As a fifth category, a series of recent business and econom-



ILLUSTRATIONS BY PAUL MEISEL

Research assistance for this article was provided by Julia Homer and Nell Margolis.

RATING THE STATES BASED ON FIVE MAJOR FACTORS

Rank/state	CAPITAL RESOURCES				LABOR			TAXES	
	Bank loans % assets	Comm./ind. loans per capita	SBIC finan. per 1,000 pop.	State programs ¹	Avg. wkly. wage	% union	% h.s. grads. over 25	Value added per worker (\$000./yr.)	Per \$1,000 personal income
Median	53.8%	\$1,111	\$1.0		\$369	23%	68%	\$39.6	\$107
1. Connecticut	56.9%	\$1,077	\$7.2	DL,LG,BG,VC	\$385	23%	71%	\$38.9	\$102
2. Massachusetts	50.8	1,671	5.3	DL,LG,BG,VC	339	25	73	36.4	121
3. California	65.6	1,780	3.6	DL,LG,BG	396	27	74	41.3	113
4. Minnesota	56.3	2,014	3.1	DL,BG,VC	396	26	72	40.8	119
5. Texas	57.1	2,779	4.3	DL	380	11	61	48.5	97
6. New Hampshire	60.5	712	3.8	LG	315	16	72	30.8	91
7. New York	56.6	4,788	3.1	DL,LG,BG	367	39	66	44.4	156
8. Washington	63.3	1,385	1.6	—	457	34	77	51.1	102
9. Kansas	51.5	1,375	1.1	VC	381	15	72	44.2	98
10. New Jersey	53.1	1,063	2.6	DL,LG,BG	392	26	68	41.8	111
11. Virginia	59.8	920	1.1	LG,BG	322	15	63	37.1	98
12. Colorado	58.4	1,409	3.9	DL,LG	380	18	78	36.2	103
13. Louisiana	52.3	1,402	1.0	DL,LG,BG,VC	402	16	58	72.3	113
14. Georgia	50.3	911	1.6	BG	312	15	57	32.0	104
15. Illinois	57.8	2,823	0.6	DL,VC	417	30	65	52.1	103
16. Delaware	72.8	4,302	0.0	—	387	25	68	36.5	109
17. New Mexico	54.5	1,267	2.2	DL,LG	309	19	68	30.6	131
18. Montana	55.6	1,667	0.7	LG,BG,VC	428	29	75	66.3	129
19. South Carolina	46.6	442	0.9	DL,LG,BG	301	8	54	30.0	103
20. Indiana	49.2	876	0.5	DL,LG,BG,VC	443	30	66	45.3	91
21. Rhode Island	55.1	1,635	1.5	DL,LG,BG	284	28	61	30.0	120
22. Pennsylvania	50.7	1,489	0.9	DL,LG,BG,VC	371	35	65	42.2	108
23. Ohio	52.2	914	1.1	DL,LG	464	31	67	45.5	94
24. Michigan	51.1	1,084	2.1	DL,LG,BG,VC	524	37	68	39.4	115
25. Florida	49.2	773	1.8	—	317	12	67	30.8	89
26. Vermont	64.9	897	0.1	DL,LG,BG	325	18	71	35.2	126
27. North Dakota	51.5	1,469	1.0	LG,BG	301	17	67	36.9	110
28. North Carolina	52.4	1,011	0.3	VC	279	10	55	30.9	101
29. Nebraska	54.1	1,154	1.0	DL	363	18	74	44.0	101
30. Arkansas	51.0	1,109	1.0	DL,BG	294	16	55	30.9	90
31. Maryland	49.4	737	0.8	DL,LG,BG	380	23*	67	43.7	110
32. Wisconsin	54.5	1,023	1.0	DL,LG,BG,VC	425	29	70	42.9	125
33. Arizona	60.7	1,056	1.2	—	378	16	72	32.9	106
34. Tennessee	49.9	967	0.8	—	314	19	55	33.3	91
35. Hawaii	55.5	1,113	0.6	DL	322	28	73	57.6	128
36. Missouri	48.5	1,281	0.2	DL,LG,BG	373	28	64	39.7	87
37. Idaho	59.6	1,177	0.9	—	339	18	73	37.6	95
38. Oklahoma	56.1	1,999	2.3	DL	396	15	67	43.2	115
39. Oregon	58.1	1,138	1.2	DL,BG	406	26	75	42.5	111
40. Kentucky	49.9	947	0.1	DL,LG,BG	367	24	52	48.1	102
41. Nevada	52.3	770	1.0	DL	367	24	76	34.3	104
42. Iowa	47.8	981	0.8	DL,VC	413	22	71	55.9	108
43. Alaska	55.0	1,568	0.2	DL,LG	491	34	83	78.7	496
44. South Dakota	70.5	1,249	1.0	—	294	15	69	36.4	105
45. Utah	57.1	899	0.9	DL	361	18	80	37.9	117
46. Alabama	47.1	800	1.4	DL	322	22	57	32.8	92
47. Maine	50.9	586	0.6	DL,LG,BG,VC	314	24	69	32.8	119
48. Wyoming	53.4	1,681	0.3	—	322	19	78	73.3	209
49. Mississippi	50.5	702	1.3	DL,LG,VC	289	16	55	33.3	101
50. West Virginia	46.1	532	.0	DL	402	34	57	53.4	114

Sources (by column, left to right): Federal Deposit Insurance Corp. (1); Data Resources Inc. (2); U.S. Small Business Administration (3); State development agencies (4); U.S. Department of Labor, Bureau of Labor Statistics (5,6); U.S. Department of Education (7); Department of Commerce, Bureau of Census (8); Tax Foundation (9); INC. survey of 50 states (10); Department of Commerce, Bureau of the Census (11); Department of Commerce, Bureau of Labor Statistics (12); U.S. Department of Commerce, Bureau of Economic Analysis (13); Bureau of the Census, County Business Patterns (14); INC. (15).

STATES REPORT

STATE SUPPORT	BUSINESS ACTIVITY				
	Pop. % change (1980-83)	Employment % gain (1981-83)	Pers. inc. % change (1981-83)	Business units per 1,000 pop.	INC.100 companies (1979-84)
Small bus. assistance ¹	2.4%	0.5%	9.5%	20	2.5
AO,OM,AC,LC,SC,PS	1.0%	1.9%	15.2%	22	11
AO,OM,AC,LC,SC,PS	0.5	2.0	16.0	21	21
AO,OM,AC,LC,SC	6.4	1.2	9.6	21	81
AO,OM,AC,LC,SC,PS	1.7	-0.1	9.2	21	23
AO,AC,LC,SC,PS	10.5	-0.9	6.9	20	41
AO,OM,AC,LC,SC	4.1	5.3	15.7	22	2
AO,OM,AC,LC,SC,PS	0.6	1.2	14.1	21	41
AO,OM,AC,LC,SC,PS	4.1	1.0	8.4	21	7
AO,OM,AC,LC,SC,PS	2.6	-2.7	9.5	23	2
AO,OM,AC,SC,PS	1.4	3.4	14.6	21	25
AO,OM,AC,LC,SC	3.8	3.9	14.0	17	8
AO,OM,AC	8.6	1.7	10.7	23	22
AO,OM,AC,LC,SC,PS	5.5	-4.9	6.4	18	2
AO,OM,AC,LC,PS	4.9	6.1	14.1	18	9
AO,OM,AC,LC,SC,PS	0.5	-4.3	8.6	19	4
AO,OM,AC,LC,SC	1.9	3.4	12.7	20	1
AO,OM,AC,SC,PS	7.4	1.2	9.9	19	2
AO,OM,AC,LC,SC	3.8	-1.9	8.2	25	0
AO,OM,AC,LC,SC,PS	4.5	1.8	10.4	17	3
AO,OM,AC,LC,SC,PS	-0.2	-2.0	8.3	18	9
AO,AC,LC,SC,PS	0.9	-0.5	13.5	22	0
AO,OM,AC,LC,SC,PS	0.3	-2.5	10.4	18	7
AO,OM,AC,LC,SC,PS	-0.5	-2.0	9.5	18	6
AO,OM,AC,LC,SC,PS	-2.1	-1.0	8.6	17	5
AO,OM,LC,SC	9.6	6.6	11.9	21	12
AO,OM,AC,SC	2.7	0.6	13.0	25	0
AO,AC,LC,SC	4.3	-0.6	4.2	24	0
AO,OM,AC,LC,SC	3.4	3.4	11.7	18	2
AO,OM,AC,SC	1.7	-0.8	6.1	24	3
AO,OM,AC,SC	1.8	3.4	10.9	18	0
AO,OM,AC,SC,PS	2.1	1.3	12.7	18	8
AO,OM,AC,LC,PS	1.0	-1.4	8.7	20	4
OM,LC,SC	9.0	5.4	9.3	18	3
AO,OM,AC,SC,PS	2.1	1.0	10.0	18	4
AO,AC,LC,SC	6.1	0.3	9.6	21	0
AO,OM,LC,SC	1.1	-0.5	10.5	20	1
AO,OM,SC	4.8	0.7	5.8	20	0
AO,SC	9.0	-4.6	5.5	20	7
AO,AC,LC	1.1	-1.6	9.4	23	4
AO,OM,AC,LC,PS	1.5	-1.1	7.2	17	1
AO,AC,SC	11.3	2.0	6.3	21	1
AO,OM,AC,LC,SC	-0.3	-3.9	2.9	23	2
AO,OM	19.2	11.3	13.5	20	1
AC	1.3	0.2	5.2	24	0
AO,AC,SC	10.8	3.2	6.8	18	1
AO,AC,LC,PS	1.7	-0.3	11.5	16	3
AO,OM,AC	1.9	1.9	13.3	20	1
—	9.5	-9.9	-1.4	26	3
AO,OM,AC	2.6	-1.2	9.2	17	1
AO,OM,LC,SC,PS	0.8	-7.1	7.6	16	0

¹ DL-direct loans; LG-loan guarantees; BG-bond guarantees; VC-venture capital.

² AO-advisory office; OM-ombudsman; AC-advisory council; LC-legislative committee; SC-statewide conference; PS-procurement set-asides.

* Includes union membership in District of Columbia.

ic statistics that describe aspects of the general business environment was included. All the information in the report, except where noted, is based on federal government data and telephone interviews with state officials.

As in previous years, our scoring system is based on 100 possible points, weighted to reflect their relative importance to most small, growing companies. Capital and state-sponsored small business support each receive 25 points, reflecting the belief that they are the most significant factors; taxation, although not an insignificant concern, was given 10 points, the lowest weighting, and labor and business activity were each allocated 20 points in recognition of their greater significance to the majority of smaller businesses. Based on this scoring system, the 1984 state totals ranged from Connecticut's 80.3 to West Virginia's 35.6.

At first glance, Connecticut, which was #9 in INC.'s 1983 rankings, is an unlikely occupant of the top rung for 1984. It has generally had significant capital resources and strong official support for small business, including the most active small business investment companies (SBICs) in the nation. But its overall business activity has usually lagged well behind that of the more dynamic states of the Sunbelt. However, Connecticut performed impressively through the last recession, particularly in the area of personal-income growth (15.2% between 1981-83). In addition, the state has continued to bolster its commitment to small business: In the past year, it has established new committees on small business in both houses of the legislature and introduced a new procurement program that encourages all state agencies to buy goods and services from small businesses.

Massachusetts, which rose to the #2 spot from #7 last year, showed a similar economic stability during the most recent business slump. Like Connecticut, the Bay State enjoyed employment and personal-income growth (up 2.05% and 15.97%, respectively) far above the national median averages. In addition, Massachusetts has significant capital resources and a variety of support programs for small business.

The traditionally high-ranking Sunbelt states sagged in the latest INC. rankings. California, which remains the leading state in the nation for capital resources, slipped only slightly, from #2 to #3. Texas, on the other hand, went from #1 to #5, Colorado from #3 to #12, and Florida from #6 to #25.

The explanations vary. Texas suffered from a substantial drop in business activity, due in large part to a lingering softness in the energy market. The Colorado economy remained quite healthy, but the state scored relatively low on its official support

of small business. Florida's drop can be traced to a combination of factors, especially the weakness of its capital resources. Of the states in 1984's overall top 10, only 4—New Hampshire, Kansas, New Jersey, and Washington—failed to score among the top 10 in capital resources. On the other hand, major weaknesses in the capital category continue to characterize nearly all of the states near the bottom of the rankings. These include West Virginia, Mississippi, Wyoming, and Alabama. West Virginia, #50 in the overall ratings, also scored last in capital resources.

There are other results worth noting. Our methodology viewed high levels of taxation as a negative, for example. But the overall rankings show only 3 low tax states in the top 10 overall—Texas, New Hampshire, and Kansas. Three of the 10—New York, Massachusetts, and Minnesota—had comparatively high tax burdens. And 2 more—New Jersey and California—were above the national median of \$107 per \$1,000 of personal income.

Similarly, INC.'s scoring system was tilted against those states with high percentages of union members. Here again, the results show only 3 low union states in the top 10, and they happen to be the same 3—Texas, New Hampshire, and Kansas. One of the goals of INC.'s states report, as noted above, is to encourage public officials to examine their small business environments with an eye toward improvement. Over the past year, South Carolina and Wisconsin have indeed taken actions to upgrade state support for smaller companies. South Carolina has established a legislative committee, an advisory council, a small business ombudsman, new state programs for direct loans, and loan and bond guarantees. With the help of these initiatives, the state rose in the rankings from #50 in 1983 to #19 in '84.

Wisconsin, for its part, has established its own list of new small business programs, which have enabled it to climb to #32 from #49 last year. Among the most significant steps it took in the past year was its creation of a new statewide financing authority that gives preference to loans for small companies.

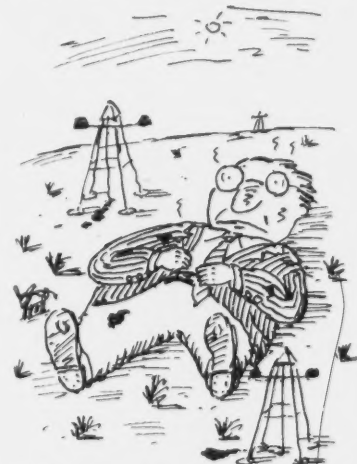
Encouraging though all these efforts are, they can only be part of a long-term program to improve the climate for small business. As politicians are slowly recognizing, few of the most important environmental factors are susceptible to a quick fix. If, for example, a state decides to improve its secondary and higher-education systems, the results may not be evident for a decade. Efforts to change the attitudes and practices of commercial bankers may take even longer. Nevertheless, it is through these types of actions that significant, lasting improvements can be made.

BEST OF SHOW

BUSINESS ACTIVITY: TROUBLE IN THE OIL PATCH

- | | |
|------------------|------------------|
| 1. New Hampshire | 6. Florida |
| 2. Colorado | 7. Georgia |
| 3. Alaska | 8. California |
| 4. New Jersey | 9. Massachusetts |
| 5. Connecticut | 10. New York |

Numbers don't often reflect the sort of drama to be found in this year's indicators of business activity. Of last year's 10 most active states, 4 have fallen from grace, with 1 dropping a full 19 rungs on the ladder. All 4 are Sunbelt states: Texas, Oklahoma, Arizona, and New Mexico. As measured by two of



the most significant indexes, personal income and employment, their growth has slowed significantly. In Oklahoma, for example, personal income and employment declined 13 and 12 percentage points, respectively, while population grew. Texas's slowdown was even more dramatic—employment down almost 15 points from last year, income down almost 13.

The cause is not hard to find: the glut of oil and gas. The Northeast states that replaced last year's most active states at the head of the pack—Connecticut, Massachusetts, New Hampshire, and New York—clearly did not gain the business activity that the Southwest lost. Populations in the New England states, for instance, grew at an even more lackluster rate than last year. And although Connecticut and New Hampshire posted improvements in employment—about 2 points each—Massachusetts lost a point. All of these states showed declines in the income category of about 3 percentage points.

The INC. study weights two fac-

tors—capital resources and state support of small business—more heavily than it does the indexes of business activity. States, after all, have more control over such matters. In the overall rankings, therefore, the Southwest did not suffer drastically. Furthermore, 1 of the dropouts from last year's top 10 in business activity—Texas—continues to be very fertile soil for companies on INC.'s list of the 100 fastest-growing public companies in America.

STATE SUPPORT: INDIANA WANTS YOU

- | | |
|------------------|---------------|
| 1. Indiana | 6. Michigan |
| 2. Connecticut | 7. Ohio |
| 3. Pennsylvania | 8. Louisiana |
| 4. Massachusetts | 9. Illinois |
| 5. New York | 10. Minnesota |

A state's eagerness to help small companies can't make up for a basic lack of capital. Increasingly, however, states are choosing to exercise whatever influence they can muster to create better environments for smaller companies.

As in past years, INC. surveyed the 50 states to determine the levels of official small business support. We measured "support" in terms of whether or not states had small business assistance offices, ombudsmen, governor's advisory councils, legislative committees, statewide conferences, and procurement set-asides for small businesses.

Two years ago, only 29 states had advisory councils on small business; this year, 42 states have them. Similarly, the number of legislative committees on small business has jumped from 26 in 1982 to 33 this year.

The states that made this year's top 10 not only offered all six programs, but also demonstrated energetic efforts to expand existing programs and add new ones. Seven of last year's top 10—Pennsylvania, Michigan, New York, Illinois, Indiana, Massachusetts, and Ohio—maintained the types of initiatives that put them on the list last year. Indiana's advancement from #6 last year to #1 reflects its ongoing efforts to upgrade both its ombudsman's office and the governor's advisory council. Connecticut's placement in the #2 spot is a result of having set up a new advisory council and two legislative committees on small business. Massachusetts, Illinois, and Pennsylvania each expanded or revamped existing programs to better serve the needs of the small business sector. Of all the 50 states, only Wyoming continued to report that it had none of the programs INC. was looking for.



LABOR: PAYING YOUR DUES

- | | |
|-----------------|------------------|
| 1. Wyoming | 6. Hawaii |
| 2. South Dakota | 7. Idaho |
| 3. Kansas | 8. Nebraska |
| 4. Vermont | 9. Utah |
| 5. Colorado | 10. North Dakota |

The labor market is a rental market. Not since the abolition of slavery has anyone sold his or her labor. The INC. survey thus presents the labor environments of the 50 states as though they were so many houses up for rent. As always, the question is, What do you get for what you pay?

On the benefit side of the ledger, we measured the states against a standard of education (percentage of high school graduates among the over-25-year-olds) and a standard of productivity (the dollar amount added by each worker to the value of manufactured goods). On the cost side, we included the average weekly wage per worker by state and the degree of unionization. It should be noted, however, that the "cost" of union labor—if it is higher at all—can be greatly outweighed, as in the case of Hawaii, by the productivity factor.

Only 3 states dropped out of 1983's top 10—Arizona, Florida, and New Hampshire—and none dropped very far. The mix of costs and benefits remains the significant thing. Only 2 of the top 10 in this category, North and South Dakota, can be said to have really low wages. By the same token, only 2 of the least unionized states, Kansas and South Dakota, made it to the best of show, and only 2 of the most productive, Wyoming and Hawaii, are included. On the other hand, 4 of the top 10 in educational level managed to attain that same status in the labor category overall.

TAXES: IS LESS MORE?

- | | |
|--------------|------------------|
| 1. Missouri | 6. New Hampshire |
| 2. Florida | 7. Alabama |
| 3. Arkansas | 8. Ohio |
| 4. Indiana | 9. Idaho |
| 5. Tennessee | 10. Texas |

If taxes were the bane of business they are reputed to be, then the 10 states with the lowest taxes, listed above, would appear as the top 10 of the whole pageant. As it happens, only 2 do, New Hampshire and Texas—which reflects the great significance of other variables in creating a hospitable business environment: capital resources, cost and quality of labor, and the like.

It is also true that elected officials nowadays seem ever more sensitive to the view that taxes are a price *they* will pay, in lost elections, for failure to serve the economic growth of their states. Thus, while New Hampshire's government boasts of its low taxes, Washington's, on the opposite side of the continent, may be heard crowing over its higher taxes. Each, however, plausibly argues that the trade-offs redound to the benefit of doing business in that particular state—in the form of increased disposable income, in one case, and in the form of superior state services in the other.

Direct comparisons among the states' tax climates are almost impossible to make. Alaska, for example, has the highest taxes—\$496 per \$1,000 of personal income—but because the state's revenues are extracted almost entirely from big energy companies, most residents pay no state or local taxes at all. Nevertheless, INC.'s survey provides a basis for comparison. Examination of taxation on each \$1,000 of personal income reveals that the 10 least-taxing states in the Union ranged a neat \$10, from Missouri's \$87 to Texas's \$97.

CAPITAL: THE NEW ACTIVISM

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| 1. California | 6. Colorado |
| 2. New York | 7. Texas |
| 3. Minnesota | 8. Oklahoma |
| 4. Connecticut | 9. Rhode Island |
| 5. Massachusetts | 10. Louisiana |

As INC.'s survey shows, the most striking development in the capital-resources area is the increasingly activist role of state governments in cultivating the growth of small businesses. The trend has been discernible since the late 1970s, when Massachusetts and Alaska established an array of programs—direct loans, bond and loan guarantees, and venture capital funds—to fill perceived gaps in the private cap-

ital markets. In the past year, the trend gathered steam, as 24 states instituted 31 new programs with the declared purpose of stimulating the small business sector.

For example, Wisconsin, which had no such programs in 1983, has since established four. Of the top 10 states in capital resources, California, Connecticut, Colorado, and Rhode Island all added one program each; 7 of the 10 now have three or more such programs. And 7 new states made initiatives in the venture capital category in the past year: Minnesota, Illinois, Wisconsin, Kansas, Mississippi, Maine, and North Carolina.

To be sure, the funds made available through these programs are not significant compared with the amount of money available at commercial banks. Industrial and commercial loans in 1983 ranged from New York's high of \$4,788 per capita to South Carolina's low of \$442. New York is a special case, however, a capital resource for the world, not just the state. On the other hand, this year's survey does give a better picture of in-state lending than last year's did. With the help of Data Resources Inc., of Lexington, Mass., our comparisons of bank loans are corrected for distortions caused by overseas lending from U.S. banks.

Venture capital investment surged in 1983, and the top-10 states clearly reflect the fact. SBIC activity declined in



only 1 of the 10—Louisiana. In 4 of the 10, moreover, the per capita investments of SBICs increased dramatically, by \$4 in Connecticut, by \$2.17 in Massachusetts, by 86¢ in Oklahoma, and by \$1.07 in Rhode Island. For Rhode Island, this was the critical factor in boosting its rank in the capital resources category.